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UNCLAS SECTION 01 OF 03 TEGUCIGALPA 002647

SIPDIS

FOR EB/TPP/ABT, WHA/EPSC, WHA/CEN  
PASS TO USTR FOR ANDREA GASH DURKIN  
PASS TO OPIC, EX-IM, TDA

E.O. 12958: N/A

TAGS: [ETRD](#) [EINV](#) [EFIN](#) [EAGR](#) [EAID](#) [KTEX](#) [HO](#)

SUBJECT: HONDURAS AND TEXTILES - DIVERSIFICATION WILL NOT BE EASY

REFS: A) SECSTATE 160692, B) TEGUCIGALPA 1391

1. Summary. Ref a requested that Post discuss the impact of the elimination of import quotas in 2005 on Honduras' textile and apparel industry and plans in the government and private sector to diversify into other industrial sectors. Embassy has been carrying on a dialogue with the GOH and Honduran private sector for the past year on the subject. The Honduran textile industry will try to survive through vertical integration and duty free status in the U.S. market. The government hopes to attract new investment in other light manufacturing, tourism, agribusiness and forestry. There is limited awareness of U.S. financing programs. End summary.

#### Textile and Apparel Industry Gearing Up for 2005

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2. As reported in ref b, Honduran maquila industry leaders recognize that quota elimination in 2005 presents a major challenge to the Honduran industry. Unrestrained by quotas, companies operating in Asia (generally considered much more competitive) will drive down prices for textiles and apparel tremendously. Industry leaders are gambling that Honduras' industry will survive based on duty free treatment in the U.S. and its close proximity to the U.S.

3. Companies are working to improve Honduran competitiveness by installing more efficient machinery and moving away from cut and sew operations to full package regimes. Due to a lack of affordable financing in the Honduran banking system, U.S. companies (with access to financing from U.S. banks) are largely responsible for the implementation of full package operations in Honduras.

4. The rapid growth of the Honduran maquila sector over the last decade is due in part to an incentives program the GOH provides for apparel assembly plants operating in designated export processing zones. Companies are exempt from paying import duties on goods and capital equipment and from state and municipal taxes. The GOH will continue to provide incentives until 2010 per WTO rules allowing countries with GDP per capita under USD 1,000 to maintain free trade zones. The general manager of the Honduran Maquila Association (AHM) commented that in anticipation of the WTO-prohibition on government incentives programs, the AHM is already engaging the GOH on alternative ways to attract (and maintain) investment in the sector.

5. To date, Honduras has had limited success in diversifying its textile and apparel production. One industry contact decried the poor job the sector has done in shedding the image of Honduras as primarily a t-shirt manufacturing center. The contact suggested that the GOH and private sector make a more concerted effort to attract companies producing higher-value finished products like fashion wear and women's attire.

#### Hopes Rest on U.S.-Central American Free Trade Agreement

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6. Industry representatives argue that a U.S.-Central American free trade agreement (USCAFTA) is essential for the sector to be able to compete in 2005 and beyond. They hope that a USCAFTA will give Honduras NAFTA-like parity and at the very least, solidify the unilateral trade preferences Honduras now enjoys under the CBTPA. Industry contacts report that Honduras, which is the largest manufacturer of knit apparel and t-shirts among CBTPA beneficiary countries, expects to benefit the most from recent provisions in the Trade Act of 2002 increasing the caps on quotas for these categories.

#### Plans for Diversification

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7. The Maduro government's recently published economic plan focuses on the need to create an attractive climate for foreign investment. The GOH's plan recognizes the need to facilitate the incorporation of a business in Honduras, seek out new trade and investment opportunities through free

trade agreements, strengthen the judicial system and resolve land tenancy problems that hinder investment (especially along Honduras' Caribbean coast). Septel will discuss current plans to attack the land tenure issues.

18. President Maduro created an entity called the Competitiveness Council to tackle investment climate issues in Honduras. The Council, which is headed by Vice President Vicente Williams and includes private sector, labor, Congress representatives and local government officials, is charged with reviewing and drafting modifications to Honduras' existing legal framework to encourage new business development. The Council recently succeeded in pushing through the National Congress the Administrative Simplification Law which reduces some bureaucratic hurdles to establishing a business in Honduras.

19. Maduro appointed Camilo Atala to a new position of Minister without Portfolio for Investment. Atala (who is also the president of Bank Ficohsa) is responsible for promoting large investment projects with potential to create substantial numbers of jobs. He is the point of contact for large international companies seeking meetings with the President and charged with clearing bureaucratic obstacles for these projects.

110. As advocated by consultant Michael Porter (a recent speaker in Tegucigalpa), the Maduro administration will concentrate on developing clusters - sectors with high potential to create jobs and related economic activity. This includes the attraction of other light industry (including electronics), developing Honduras' tourism potential, strengthening the agro-industry and exploiting Honduras' natural resources (primarily forestry and mining).

111. There has been limited success in attracting non-textile light assembly operations. The ZIP Calpules industrial park (located in San Pedro Sula), for example, is already home to a biotechnology firm that propagates cultivars (primarily banana) for export and businesses producing wire harnesses and high-end doors and furnishings made from Honduran mahogany for export, among others. Recently, a U.S. company manufacturing wire harnesses for U.S. automakers announced plans to hire 1,500 new employees. The company has also expanded into building high cost mail sorters for major U.S. buyers and has plans to expand into other high-value assembly operations.

112. USAID has enjoyed success with its agricultural diversification program run by FINTRAC, an U.S. company working with small farmers to diversify into profitable nontraditional agriculture exports (primarily vegetables). Through the use of improved production and processing technologies, FINTRAC has helped many participating small farmers access the U.S. agricultural market.

113. A USDA-funded hot water treatment plant for mangos began operating in April 2002, permitting Honduran mango producers for the first time to meet U.S. med-fly phytosanitary requirements. USDA expects the use of the plant to be expanded to include papayas during the mango growing season. USDA has also worked with Honduran cheese producers to meet U.S. sanitary restrictions and qualify to export ethnic cheese products to the U.S.

#### Challenges to Diversification

114. The challenges to improvement of the investment climate are formidable. The judicial system continues to be weak and inefficient; the courts are easily manipulated and it is difficult to enforce contracts. An August 2001 law permitting arbitration led to the creation of Honduras' first arbitration center in the Tegucigalpa Chamber of Commerce; however, only one case has been submitted for arbitration.

115. The GOH has been unable to envision a solution to existing land disputes and the greater problem of land tenancy in Honduras. The Agrarian Reform Law, which resulted in the titling of land for hundreds of thousands of Honduras' landless poor, has encouraged land invasions in some cases. The Maduro administration is in the process of developing a law to consolidate Honduras' land registries and modify the Agrarian Reform Law; however, it may be a long time before any progress is made on land issues.

116. A fragile Honduran banking system and high interest, short-term loans continue to stifle new investment. Attempts to privatize the electricity distribution system and telecom sectors have been met with resistance in the private sector and National Congress. Meanwhile, electricity prices and telephone rates are among the highest in the region.

117. Recent minimum wage hikes, the implementation of double salary payments in June and December, high severance payment

requirements and a government mandated increase in employer social security contributions have all contributed to an increase in the cost of doing business in Honduras.

#### Role of USG Financing Programs

18. There is limited awareness of USG financing programs such as the Overseas Private Investment Corporation (OPIC), the Export-Import Bank and the Trade Development Agency (TDA). The TDA is working with Honduras' telecom regulatory agency (CONATEL) on studies to strengthen and liberalize the telecom sector. We are aware of little OPIC or Ex-Im financing at this time. USDA recently put on a well-attended seminar on its agricultural financing programs. A similar seminar on opportunities for OPIC, Ex-Im Bank and TDA opportunities would be welcome.

Pierce